

AMENDED IN ASSEMBLY MARCH 25, 2003

CALIFORNIA LEGISLATURE—2003–04 REGULAR SESSION

ASSEMBLY BILL

No. 263

Introduced by Assembly Member Oropeza
(Coauthors: Assembly Members Firebaugh, Strickland, and Wyland)

February 4, 2003

An act to ~~amend~~ *repeal and add* Section 24410 of the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.

LEGISLATIVE COUNSEL'S DIGEST

AB 263, as amended, Oropeza. Bank and corporation taxes: deduction: insurance company dividends.

The Bank and Corporation Tax Law allows various deductions in computing the income that is subject to the taxes imposed by that law, including a deduction for dividends received by a corporation, commercially domiciled in California, from an insurance company that is subject to insurance tax. Existing law provides that a corporation may only deduct dividends that were paid from the insurance company's California source income. The amount of the dividends eligible for a deduction is further limited and is determined by multiplying the total amount of the dividends by an apportionment factor, equal to the ratio of gross income from California sources to all gross income of the insurance company paying the dividends.

This bill would ~~delete these requirements and limitations, and would~~ *instead allow a corporation, whether or not engaged in business in California, to take a deduction for an unspecified percentage of the amount of the dividend received from an insurance company and also*

allow ~~any corporation~~ a *qualified taxpayer, as defined*, to take a similar dividend received deduction, ~~including a corporation that is not commercially domiciled in California~~ with respect to certain open years, and would make legislative findings and declarations in connection thereto.

This bill would take effect immediately as a tax levy.

Vote: majority. Appropriation: no. Fiscal committee: yes.
State-mandated local program: no.

The people of the State of California do enact as follows:

1 ~~SECTION 1. Section 24410 of the Revenue and Taxation~~
2 ~~SECTION 1. Section 24410 of the Revenue and Taxation Code~~
3 ~~is repealed.~~
4 ~~24410. (a) Dividends received by a corporation~~
5 ~~commercially domiciled in California during the taxable year~~
6 ~~from an insurance company subject to tax imposed by Part 7~~
7 ~~(commencing with Section 12001) of this division at the time of~~
8 ~~the payment of the dividends and at least 80 percent of each class~~
9 ~~of its stock then being owned by the corporation receiving the~~
10 ~~dividend.~~
11 ~~(b) The deduction under this section shall be limited to that~~
12 ~~portion of the dividends received which are determined to be paid~~
13 ~~from income from California sources determined pursuant to~~
14 ~~subdivision (c).~~
15 ~~(c) Dividends paid from California sources shall be determined~~
16 ~~by multiplying the amount of the dividends by an apportionment~~
17 ~~factor equal to the ratio of gross income from California sources~~
18 ~~to all gross income of the company. Gross income from California~~
19 ~~sources equals total gross income less dividends from other~~
20 ~~insurance companies multiplied by the average of the following~~
21 ~~three factors:~~
22 ~~(1) A gross receipts factor, the denominator of which shall~~
23 ~~include all receipts, other than dividends from another insurance~~
24 ~~company, regardless of the nature or source from which derived.~~
25 ~~The numerator of which shall include all gross receipts, other than~~
26 ~~dividends from another insurance company, derived from or~~
27 ~~attributable to this state. With respect to premiums, only receipts~~
28 ~~which were subject to tax under Part 7 (commencing with Section~~
29 ~~12001) of this division, shall be included in the numerator, and~~

with respect to income from intangibles they shall be attributable to the commercial domicile of the insurance company.

(2) A payroll factor determined under the provisions of the Uniform Division of Income for Tax Purposes Act, Chapter 17, Article 2 of this part.

(3) A property factor, determined under the provisions of the Uniform Division of Income for Tax Purposes Act provided for in Article 2 (commencing with Section 25120) of Chapter 17 of this part, provided that for the purposes of this paragraph the property factor shall include all intangible investment property, which intangible property shall be allocated to the commercial domicile of that insurance company.

(4) Plus the portion of the dividends received from another insurance company determined to be paid from California source income pursuant to the formula set forth in paragraphs (1) through (3) based upon the receipts, payroll and property of that other insurance company.

(d) The insurance company from which the dividends are received shall furnish that information as the Franchise Tax Board may require to determine the allocation formula and the Franchise Tax Board may adopt those regulations as it deems necessary to effectuate the purpose of this section.

Nothing in this section shall be construed to limit or affect in any manner any other provisions of this part.

SEC. 2. Section 24410 is added to the Revenue and Taxation Code, to read:

24410. (a) For taxable years commencing on or after January 1, 2003, ____ percent of the amount of dividends received by a corporation during the taxable year from a corporation that is an insurer within the meaning of Section 28 of Article XIII of the California Constitution, whether or not the insurer is engaged in business in California, if at the time of each dividend payment at least 80 percent of each class of the stock of the insurer were owned, directly or indirectly, by the corporation receiving the dividend.

(b) (1) For all taxable years ending on or after December 1, 1997, and commencing before January 1, 2003, a qualified taxpayer may elect to determine its deduction for dividends received during each taxable year from a corporation that is an insurer within the meaning of Section 28 of Article XIII of the

1 *California Constitution in an amount equal to _____ percent of the*
2 *dividends received.*

3 (2) A “qualified taxpayer” means a corporation that does both
4 of the following:

5 (A) *Timely files amended state returns for all taxable years*
6 *ending on or after December 1, 1997, and commencing before*
7 *January 1, 2003, expressly electing to be subject to the dividends*
8 *received deduction in accordance with the percentage set forth in*
9 *paragraph (1) of this subdivision, and reporting and remitting all*
10 *amounts due pursuant to that election.*

11 (B) *Agrees that, for purposes of this subdivision, dividends that*
12 *constitute business income are deductible only in the percentage*
13 *set forth in paragraph (1) of this subdivision.*

14 (3) *For purposes of determining taxable income on the*
15 *amended returns filed pursuant to the election set forth in*
16 *paragraph (1), Section 24425 does not apply to the amount of the*
17 *dividends received deduction.*

18 (4) *An amended return is deemed to be timely filed for purposes*
19 *of subparagraph (A) of paragraph (2) if it is filed within 180 days*
20 *of the effective date of this act. Failure to file all amended returns*
21 *within that period or to remit to the Franchise Tax Board the full*
22 *amount of the tax underpayment due pursuant to the election*
23 *described in paragraph (1) disqualifies the taxpayer from making*
24 *that election.*

25 (5) *The election shall be irrevocable and shall apply to all*
26 *taxable years of the taxpayer during the period identified in*
27 *paragraph (1) of this subdivision.*

28 SEC. 3. (a) *The Legislature finds and declares that the*
29 *amendments made by this act to Section 24410 of the Revenue and*
30 *Taxation Code serve a public purpose and are necessary to provide*
31 *for the equitable tax treatment of insurance company dividends in*
32 *light of the following circumstances:*

33 (1) *The California Court of Appeal in a final decision in the*
34 *case of Ceridian Corp. v. Franchise Tax Board (2000) 85*
35 *Cal.App.4th 875 held that provisions of Section 24410 of the*
36 *Revenue and Taxation Code that limited a deduction with respect*
37 *to dividends received from subsidiaries engaged in the insurance*
38 *business to corporations “commercially domiciled” in California,*
39 *and to insurance company dividends paid from “income from*

1 *California sources,” violated the commerce clause of the United*
2 *States Constitution.*

3 *(2) In general, insurance companies are not subject to the*
4 *Corporation Tax Law and cannot be included in the combined*
5 *report used to determine the California income of related*
6 *corporations that are subject to the Corporation Tax Law.*
7 *Consequently, dividends that are paid by insurance companies do*
8 *not qualify for a deduction under Section 24402 of the Revenue*
9 *and Taxation Code and are not eligible for elimination from*
10 *income as provided for in Section 25106 of the Revenue and*
11 *Taxation Code.*

12 *(3) In light of the uncertainty following the decision in Ceridian*
13 *Corp. v. Franchise Tax Board, a number of corporations filed*
14 *returns with Franchise Tax Board in which they claimed*
15 *deductions for all or part of the dividends that they received from*
16 *insurance subsidiaries. If the corporations are not entitled to those*
17 *deductions claimed with respect to such dividends, additional*
18 *taxes and interest will be due.*

19 *(4) The Legislature finds and declares that the amendments to*
20 *Section 24410 of the Revenue and Taxation Code made by this act*
21 *serve a public purpose and are in furtherance of the public interest*
22 *in avoiding the unanticipated denial of a deduction with respect to*
23 *a portion of the dividends paid by insurance companies. Denial of*
24 *a deduction with respect to those dividends will have a detrimental*
25 *effect upon the economy of California.*

26 *(5) The Legislature further finds and declares that the*
27 *application of the amendments made by this act to taxable years*
28 *ending on or after December 1, 1997, and commencing before*
29 *January 1, 2003, serves a public purpose and is in furtherance of*
30 *legislative intent underlying the enactment of Section 24410 of the*
31 *Revenue and Taxation Code. The Legislature further finds and*
32 *declares that the application of the amendments to Section 24410*
33 *of the Revenue and Taxation Code made by this act promote a*
34 *public purpose and sound tax policy by affording equitable tax*
35 *relief to many taxpayers who relied upon the literal language of*
36 *Section 24410 of the Revenue and Taxation Code in the*
37 *expectation that they would be entitled to a deduction with respect*
38 *to a portion of the dividends received from insurance companies.*

39 *(b) The Legislature further finds and declares all of the*
40 *following:*

1 (1) Section 24425 of the Revenue and Taxation Code denies a
2 deduction with respect to any amount otherwise allowable as a
3 deduction that is allocable to a class of income that is not included
4 in the measure of tax. In general, the Franchise Tax Board
5 maintains that Section 24425 of the Revenue and Taxation Code
6 applies to limit expense deductions associated with insurance
7 company dividends to the extent those dividends are deductible
8 under Section 24410 of the Revenue and Taxation Code. Some
9 taxpayers contend that Section 24425 of the Revenue and Taxation
10 Code does not apply to a Section 24410 of the Revenue and
11 Taxation Code. Some taxpayers contend that Section 24425 of the
12 Revenue and Taxation Code does not apply to a Section 24410 of
13 the Revenue and Taxation Code deduction under any
14 circumstance.

15 (2) The determination of the amount of an otherwise allowable
16 deduction that is allocable to a class of income that is not included
17 in the measure of tax can be a difficult and subjective judgment and
18 often is not resolved without litigation.

19 (3) Paragraph (3) of subdivision (b) of Section 24410 of the
20 Revenue and Taxation Code that declares Section 24425 of the
21 Revenue and Taxation Code inapplicable to the dividends received
22 deduction for tax years ending on or after December 1, 1997, and
23 commencing before January 1, 2003, represents an integral part
24 of the legislative resolution of the uncertainty created by the
25 Ceridian decision, and is accordingly added by this act in
26 furtherance of the same valid public purposes identified above.

27 (4) For tax years ending prior to December 1, 1997, however,
28 the Ceridian decision has required a full dividends received
29 deduction under Section 24410 of the Revenue and Taxation Code
30 for taxpayers procedurally entitled to assert claim for refund
31 thereto, and the Franchise Tax Board maintains that Section
32 24425 of the Revenue and Taxation Code applies to limit
33 deductions allocable to these dividends. No inferences should
34 arise from the amendment to subdivision (b) of Section 24410 of
35 the Revenue and Taxation Code by this act with respect to the
36 application of Section 24425 of the Revenue and Taxation Code to
37 deductions allocable to the dividends deductible under Section
38 24410 of the Revenue and Taxation Code for tax years ending
39 before December 1, 1997, or commencing on or after January 1,
40 2003.



(c) The Legislature further declares that the tax treatment of insurance company dividends under Section 24410 of the Revenue and Taxation Code, as amended by this act, is unrelated to and distinguishable from the tax treatment of general corporation dividends under Section 24402 of the Revenue and Taxation Code and from the application of Section 24425 of the Revenue and Taxation to deductions allocable to those dividends. The Legislature further finds and declares that no inference with respect to Section 24402 of the Revenue and Taxation Code or the applicability of Section 24425 of the Revenue and Taxation Code to deductions allocable to those dividends should be drawn from the amendments made to Section 24410 of the Revenue and Taxation Code by this act.

SEC. 4. This act provides for a tax levy within the meaning of Article IV of the Constitution and shall go into immediate effect. Code is amended to read:

~~24410. (a) For taxable years ending on or after December 1, 1997, there shall be allowed as a deduction to a taxpayer _____ percent of the dividends received by a corporation during the taxable year from an insurance company subject to tax imposed by Part 7 (commencing with Section 12001) of this division at the time of the payment of the dividends, whether or not the insurance company is engaged in business in California, if at least 80 percent of each class of its stock was then being owned by the corporation receiving the dividend.~~

~~(b) Section 24425 does not apply to any expense that is related to dividends that are deductible under subdivision (a) of this section.~~

SEC. 2. The Legislature finds and declares all of the following:

(a) The amendments made by this act to Section 24410 of the Revenue and Taxation Code are necessary to provide for the equitable tax treatment of insurance company dividends in light of the following circumstances:

(1) The California Court of Appeal in a final decision in the case of *Ceridian Corp. v. Franchise Tax Board* (2000) 85 Cal.App.4th 875, held that the portions of Section 24410 of the Revenue and Taxation Code that refer to corporations “commercially domiciled” in California and to insurance company dividends paid from “income from California sources”

1 ~~violated the commerce clause of the United States Constitution. As~~
2 ~~a consequence of this decision, uncertainty exists regarding~~
3 ~~whether Section 24410 of the Revenue and Taxation Code remains~~
4 ~~in effect and provides for a full dividends received deduction or~~
5 ~~whether it was invalidated in its entirety by the Ceridian decision~~
6 ~~with the result that no dividends received deduction is available~~
7 ~~with respect to insurance company dividends.~~

8 (2) ~~In light of the foregoing, the amendment to Section 24410~~
9 ~~of the Revenue and Taxation Code by this act is required to address~~
10 ~~this uncertainty and the deduction provided in this act with respect~~
11 ~~to dividends received from insurance subsidiaries represents a fair~~
12 ~~and equitable result for all concerned.~~

13 (3) ~~The amendments to Section 24410 of the Revenue and~~
14 ~~Taxation Code made by this act are in furtherance of a public~~
15 ~~purpose in avoiding the unintended impairment of the ability of~~
16 ~~California-based insurance holding companies to compete~~
17 ~~nationally and the detrimental effect upon the state economy of an~~
18 ~~uncertain and potentially unfair result that discourages the~~
19 ~~establishment and expansion of California insurance-related~~
20 ~~activities by out-of-state insurance holding companies.~~

21 (4) ~~The retroactive application of the amendments to Section~~
22 ~~24410 of the Revenue and Taxation Code made by this act to tax~~
23 ~~years ending on and after December 1, 1997, is in furtherance of~~
24 ~~a valid public purpose and sound tax policy. The Legislature~~
25 ~~originally enacted Section 24410 of the Revenue and Taxation~~
26 ~~Code in 1968, and, had it known then of the constitutional~~
27 ~~infirmities of the statute adjudicated in the Ceridian case, would~~
28 ~~have preferred the dividend relief provided by this act to the~~
29 ~~prospect that Section 24410 of the Revenue and Taxation Code~~
30 ~~might fall in its entirety and provide no dividend relief whatsoever.~~
31 ~~The retroactive application of the amendments to Section 24410~~
32 ~~of the Revenue and Taxation Code made by this act promotes~~
33 ~~sound tax policy by affording equitable tax relief to the many~~
34 ~~taxpayers who relied upon Section 24410 of the Revenue and~~
35 ~~Taxation Code for dividends received deductions that now may be~~
36 ~~in jeopardy.~~

37 (b) ~~Subdivision (b) of Section 24410 of the Revenue and~~
38 ~~Taxation Code, which declares Section 24425 of the Revenue and~~
39 ~~Taxation Code to be inapplicable to the dividends received~~
40 ~~deductions for tax years commencing on and after December 1,~~

1997, represents an integral part of the legislative resolution of the uncertainty created by the Ceridian decision, and is accordingly added by this act in furtherance of the same valid public purposes identified above.

(e) For tax years commencing prior to December 1, 1997, however, the Ceridian decision has required a full dividends received deduction under Section 24410 of the Revenue and Taxation Code for taxpayers procedurally entitled to assert claims for refund thereto, and the Franchise Tax Board maintains that Section 24425 of the Revenue and Taxation Code applies to offset expense deductions associated with these dividends. In light of this pending controversy, no inferences should arise from the addition of subdivision (b) of Section 24410 of the Revenue and Taxation Code by this act with respect to the application of Section 24425 of the Revenue and Taxation Code to dividends received deductions under Section 24410 of the Revenue and Taxation Code for tax years commencing before December 1, 1997.

SEC. 3. The Legislature further finds and declares that the tax treatment of insurance company dividends under Section 24410 of the Revenue and Taxation Code, as amended by this act, is unrelated to and distinguishable from the tax treatment of the deduction of general corporate dividends under Section 24402 of the Revenue and Taxation Code and the application of Section 24425 of the Revenue and Taxation Code to those deductions. In that regard, the Legislature recognizes that California combined reporting groups with insurance affiliates differ from general corporations insofar as the insurance affiliates are excluded from the California combined report, and therefore cannot eliminate insurance subsidiary dividends under Section 25106 of the Revenue and Taxation Code, whereas general corporate unitary affiliates may do so. The Legislature further recognizes that California combined reporting groups with insurance affiliates are subject to gross premiums taxation over and above the corporate income tax, whereas general corporations are not.

SEC. 4. This act provides for a tax levy within the meaning of Article IV of the Constitution and shall go into immediate effect.

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